

Internal Revenue Service

District  
Director

Department of the Treasury

1100 Commerce St., Dallas, Texas 75242

Date: MAR 30 1998

Employer ID Number:

Person to Contact:

Telephone Number:

Refer Reply To:

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code.

You incorporated as a non-profit corporation in [REDACTED]. Your purpose included general section 501(c)(3) language, including educational and charitable.

Your activities were described as providing efficient, affordable Internet access to rural communities where Internet subscribers would otherwise be compelled to pay long distance phone charges and fees in amounts that would deter most consumers from utilizing the Internet. You operate a web site, pay for telephone line and Internet access, solicit personal, commercial and institutional accounts and coordinate Internet educational activities.

Your financial data showed your only sources of revenues as investment income and unrelated business income, totaling \$[REDACTED] for the most recent year. Your major expenses are phone lines, equipment and contract with a [REDACTED]. Your balance sheet currently shows a net fund balance of \$44,650. Through the [REDACTED] you contract for access to their Internet domain and provision of labor needed to maintain the Internet equipment and carry on administrative tasks.

As of [REDACTED], you indicated you had [REDACTED] commercial subscribers who pay between \$[REDACTED] and \$[REDACTED] per month. You had [REDACTED] personal subscribers who pay between \$[REDACTED] and \$[REDACTED] per month. The variance in monthly fees is due to location and state tax. Service is generally limited to paying subscribers, although you indicate you provide services free to some libraries.

Section 501(c)(3) of the Code provides exemption for:

"Corporations...organized and operated exclusively for religious, charitable...or educational purposes...no part of the net earnings of which inures to the benefit of any private shareholder or individual..."

Section 1.501(c)(3)-1(b)(1)(i) of the Income Tax Regulations provides that an organization is organized exclusively for one or more exempt purposes only if its Articles of Organization -

- "(A) Limit the purposes of such organization to one or more exempt purposes; and
- (B) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes."

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that:

"An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3)..."

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that all the organizations there described must serve a public rather than a private interest.

Section 1.501(c)(3)-1 of the regulations provides, in part, as follows:

"(a)(1) In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt."

"(c)(1) Primary activities. An organization will be regarded as 'operated exclusively' for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."

"(e)(1) In general. An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513..."

Revenue Ruling 54-394, 1954-2 C.B. 31 denies section 501(c)(4) exemption to an entity whose primary purpose is to provide television service in an area not readily adaptable to ordinary reception. Service is provided to members who contract for services and pay fees. The organization was found to benefit members and not the community.

In Federation Pharmacy Services, Inc. v. Commissioner, 625 F. 2d 804 (8th Cir. 1980), aff'g Tax Court, 72 T.C. 687 (1979), an entity was found not to be exempt since it sold drugs at discount or cost to elderly and handicapped, but did not prove it made a commitment to sell drugs below cost, and financial



status was not considered as prerequisite to membership. Entity was operated primarily for commercial purposes in competition with profit-making drug stores.

Your only activity is the operation of an Internet service which is a commercial activity and competes with the large number of commercial enterprises that provide Internet services. Regulations quoted indicate an organization is not exempt where it is operated for the primary purpose of carrying on an unrelated trade or business.

You indicate the purpose of carrying on the Internet service is educational and charitable. Education may or may not result from Internet service since such service can be used for recreation, business and social purposes. Each subscriber will determine for what purpose he will use the service. Since you provide services to anyone who is willing to subscribe and pay the required fees, you serve no charitable class; you serve all members of the public who subscribe. You refer to the Internet as improving the quality of life which is instrumental in attracting and retaining personnel in rural areas. The service you provide is available from commercial providers, but at a higher rate. You make local calls whereas other providers of this service use long-distance. Therefore, your provision of services only makes it cheaper to subscribers, not available where it would not otherwise be available. Like the organization in Federation Pharmacy Services, you are making commercial services cheaper to an area, which does not further any charitable purpose.

You have not shown that your furnishing of an Internet service furthers an exempt purpose. You do not qualify for exemption because you operate for the primary purpose of carrying on an unrelated trade or business contrary to the Regulations cited and like the court case cited which was not exempt. The fact that you reported revenue from the activity as unrelated trade or business confirms that you believed it was an unrelated trade or business. Further since your activity benefited members only, it served their private benefit rather than public benefits as evidenced by Revenue Ruling 54-394.

Accordingly, you are not exempt under section 501(c)(3) of the Code and should file Form 1120. Contributions to you are not tax deductible by donors.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. The enclosed Publication 892 gives instructions for filing a protest.

If you do not file a protest with this office within 30 days of the date of this report or letter, this proposed determination will become final.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Code as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides in part that, "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Court of Claims, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

If this determination letter becomes a final determination, we will notify the appropriate State Officials, as required by section 6104(c) of the Code, that based on the information we have, we are unable to recognize you as an organization of the type described in Code section 501(c)(3).

If you agree with these conclusions or do not wish to file a written protest, please sign and return Form 6018 in the enclosed self-addressed envelope as soon as possible.

If you have any further questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

*Glenn E. Henderson*

Glenn E. Henderson  
District Director

Enclosures:  
Publication 892  
Form 6018



Department of the Treasury-Internal Revenue Service  
**Consent to Proposed Adverse Action**  
(All references are to the Internal Revenue Code)

Prepare In  
Duplicate

Case Number

Date of Latest Determination Letter

Employer Identification Number

Date of Proposed Adverse Action Letter

Name and Address of Organization

I consent to the proposed adverse action relative to the above organization as shown by the box(es) checked below. I understand that if Section 7428, Declaratory Judgments Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

**NATURE OF ADVERSE ACTION**

- ☒ Denial of exemption under section 501(c)(3) of the Code.
- ☐ Revocation of exemption, effective
- ☐ Modification of exempt status from section 501(c)( ) to 501(c)( ), effective
- ☐ Classification as a private foundation (section 509(a)), effective
- ☐ Classification as a non-operating foundation (section 4942(j)(3)), effective
- ☐ Classification as an organization described in section 509(a)( ), effective
- ☐ Classification as an organization described in section 170(b)(1)(A)( ), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgment under section 7428.

(Signatures and instructions are on the back of this form.)

Name of Organization

Signature and Title

Date

Signature and Title

Date